

Ref. No.
Release

Date

Signature

[REDACTED]

Employer Identification Number:
Key District: [REDACTED]

Dear Applicant:

This refers to your application for recognition of exemption from federal income tax as an organization described in section 501(c)(15) of the Internal Revenue Code.

The information furnished shows that you were incorporated under the laws of the [REDACTED] on [REDACTED]. You registered as a continuing corporation under the laws of the [REDACTED]. You applied for recognition of exemption under section 501(c)(15) of the Code on December 18, 1996.

You were formed to provide reinsurance to cover certain warranty agreements or service contracts for vehicles sold by [REDACTED]. You are owned by [REDACTED] interest. [REDACTED] also holds a 99% interest in [REDACTED] the remaining 1% interest is owned by [REDACTED], who is [REDACTED]. Your officers and directors are as follows:

[REDACTED] President and Director
[REDACTED] Director/Officer
[REDACTED] Director/Officer

The information furnished shows that a customer who purchases a warranty service contract is covered to the extent of the terms of such contract. You state that you reinsured vehicle service contracts sold by [REDACTED].

The vehicle service contracts require the dealers to make necessary repairs to certain components which are not covered by a manufacturer's warranty at the time of breakdown. Customers may pay additional amounts to ensure that the dealer repairs parts covered by a manufacturer's warranty after that warranty has expired.

[REDACTED]

You entered into a reinsurance contract with [REDACTED]. Under this contract, [REDACTED] reinsured all of the vehicle service contracts issued by the dealership, [REDACTED], with you.

The financial information furnished shows that you had net written premium income for [REDACTED] of [REDACTED] for [REDACTED] and [REDACTED] for [REDACTED]. Your Annual Report for [REDACTED] shows that your capital and surplus as of [REDACTED], was [REDACTED].

Section 501(c)(15) of the Code was amended to provide for the exemption of:

(A) Insurance companies or associations other than life (including interinsurers and reciprocal underwriters) if the net written premiums (or, if greater, direct written premiums) for the taxable year do not exceed \$350,000."

This subsection also provides:

(B) For purposes of subparagraph (A), in determining whether any company or association is described in subparagraph (A), such company or association shall be treated as receiving during the taxable year amounts described in subparagraph (A) which are received during such year by all other companies or associations which are members of the same controlled group as the insurance company or association for which the determination is being made.

(C) For purposes of subparagraph (B), the term controlled group has the meaning given such term by section 831(b)(2)(B)(ii).

The principal test for what constitutes "insurance" is set out in Helvering v. LeGierse, 312 U.S. 531 (1941). In that case the Supreme Court stated that "[h]istorically and commonly insurance involves risk-shifting and risk-distribution...." Id. at 539. Further, the Court stated that "the risk must be an 'insurance risk' as opposed to an 'investment risk'...." Id. at 542. In Allied Fidelity Corp. v. Commissioner, 66 T.C. 1068, 1074 (1976), aff'd, 572 F.2d 1190 (7th Cir. 1978), the Tax Court wrote that this risk is a risk of "a direct or indirect economic loss arising from a defined contingency," so that an "essential feature of insurance is the assumption of another's risk of economic loss."

Rev. Rul. 77-316, 1977-2 C.B. 53, addressed three situations in which a domestic corporation and its domestic subsidiaries paid amounts, designated as insurance premiums, directly or

[REDACTED]

indirectly to the parent's wholly owned foreign "insurance" subsidiary. In Situation 1, the parent and its subsidiaries paid amounts directly to the insurance subsidiary. In Situation 2, the parent and its subsidiaries paid amounts to M, an unrelated domestic insurance company, under a contractual arrangement providing that M would remain as the primary insurer but immediately "reinsure" 95 percent of the risks received with the parent's subsidiary. In Situation 3, the parent and its subsidiaries paid amounts directly to the insurance subsidiary, but the insurance subsidiary then transferred 90% of the risks to W, an unrelated insurance company, in a reinsurance transaction. The ruling noted that, in all situations, the insurance subsidiary and the parent's other subsidiaries were under the common control of the parent. In no situation did the insurance subsidiary accept risks from parties other than the parent and its domestic subsidiaries.

Rev. Rul. 77-316 concluded that the arrangements in each of the these situations under which the insurance subsidiary assumed "a portion of the risks" of the parent and its domestic subsidiaries was "not insurance under the standards set forth in Le Gierse." Id. at 55. It held that the subsidiaries were "not insurance companies" ... because their primary and predominant business activity was not the issuing of insurance or annuity contracts or reinsuring of risks underwritten by other insurance companies. Id. at 56.

Following Rev. Rul. 77-316, other revenue rulings placed importance on the captive insurer and the insured as being, or not being, under control. In Rev. Rul. 78-338, 1978-2 C.B. 107, 31 unrelated shareholders owned a corporation from which they purchased insurance; no shareholder's individual risk could exceed 5% of the total risks insured by the company. The ruling stated that "no shareholder owned a controlling interest in the insurance company," and concluded that, "because the taxpayer and the other insureds-shareholders are not economically related," the arrangement would be treated as insurance for federal income tax purposes. In Rev. Rul. 83-172, 1983-2 C.B. 107, 40 employers formed a insurance exchange for the purpose of insuring their liability under the state workmen's compensation law. No single employer in the group provided more than 5 percent of the total risk insured by the fund. The ruling found that the members of the group were not "economically related or commonly controlled." Id. It held that the fund would be treated as an insurance company other than a life insurance company for federal income purposes. Id. at 108.

Your sole business is [REDACTED] the risks of your [REDACTED]
[REDACTED] on which the

[REDACTED] is liable. Both you and the [REDACTED] are under the common control of the same majority shareholder. Your business is substantially similar to that of the company in Situation 2 of Rev. Rul. 77-316. We find that you are not an insurance company or association other than life, and your request for recognition of exemption under section 501(c)(15) of the Code is denied.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views, with a full explanation of your reasoning. This statement, signed by one of your officers, must be submitted within 30 days of the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practices Requirements.

You will expedite our receipt of your protest statement by using the following address on the envelope:

[REDACTED]

If we do not hear from you within 30 days, this ruling will become final and copies will be forwarded to the Southeast key District Office, which is located in Baltimore, Maryland. Thereafter, any question about your federal income status should be addressed to that office.

Enclosure:
Key District List

Sincerely yours,
[REDACTED]